

**DEPARTMENT OF STATE REVENUE**

**SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 02-0518**

**Income Tax  
For Tax Year 1998**

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**ISSUE**

**I. Income Tax—Sales Factor**

**Authority:** 45 IAC 3.1-1-51; 45 IAC 3.1-1-52; 45 IAC 3.1-1-153

Taxpayer protests the calculation of its sales factor denominator for 1998.

**STATEMENT OF FACTS**

Taxpayer operates a business in Indiana and several other states. As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments for the years 1996-1998. Taxpayer protested some of the proposed assessments and paid some of the proposed assessments. An administrative hearing was held and a Letter of Findings ("LOF") was issued sustaining taxpayer's protest in part and denying taxpayer's protest in part. Taxpayer requested and was granted a rehearing. In the rehearing, taxpayer argued that the Department erred in its calculation of the sales factor denominator for the year 1998. Further facts will be supplied as required.

**I. Income Tax—Sales Factor**

**DISCUSSION**

Taxpayer protests that the Department erred in its calculation of taxpayer's sales factor denominator for the year 1998. The Department conducted an audit and made several adjustments, including adjustments to taxpayer's apportionment factors. One of the adjustments to the apportionment factors included recalculating the sales factor. The Department determined that taxpayer had understated some sales relating to partnerships in its sales factor numerator and denominator. Taxpayer now claims that the Department under-corrected on the sales factor denominator. Taxpayer's position is that by using the amount it believes is correct in the denominator, its Indiana apportionment percentage will decrease and it will not owe Indiana adjusted gross income tax for 1998, but will in fact be due a refund for 1998 adjusted gross income tax already paid.

The sales factor denominator is explained in 45 IAC 3.1-1-51, which states:

The denominator of the sales factor includes all gross receipts from the taxpayer's sales, except as noted in Regulation 6-3-2-2(1)(010) [45 IAC 3.1-1-62]. The denominator shall not include sales made between members of an affiliated group filing consolidated returns under IC 6-3-4-14.

The sales factor numerator is explained in 45 IAC 3.1-1-52, which states:

The numerator of the sales factor generally includes gross receipts from sales attributable to this state, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales regardless of the place where the accounting records are maintained or the location of the contract or other evidence of indebtedness. The numerator shall not include sales between members of an affiliated group filing consolidated returns under IC 6-3-4-14.

The treatment of partnership income for the sales factor is explained in 45 IAC 3.1-1-153, which states:

- (a) A corporate partner's share of profit or loss from a partnership will be included in its federal taxable income and therefore generally subject to the same rules as any other adjusted gross income.
- (b) If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors for any partnership year ending within or with the corporate partner's income year, with the following modifications:
  - (1) The value of property which is rented or leased by the corporate partner to the partnership or vice versa shall, with respect to the corporate partner, be excluded from the property factor of the partnership or eliminated to the extent of the corporate partner's interest in the partnership, whichever the case may be, in order to avoid duplication.
  - (2) Intercompany sales between the corporate partner and the partnership shall be eliminated from the corporate partner's sales factor as follows:
    - (A) Sales by the corporate partner to the partnership to the extent of the corporate partner's interest in the partnership.
    - (B) Sales by the partnership to the corporate partner not to exceed the corporate partner's interest in all partnership sales.
- (c) If the corporate partner's activities and the partnership's activities do not constitute a unitary business under established standards, disregarding ownership requirements, the corporate partner's share of the partnership income attributable to Indiana shall be determined as follows:
  - (1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be

determined by a three (3) factor formula consisting of property, payroll, and sales of the partnership.

(2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment.

(d) A partner's distributive share of income will be adjusted by the partner's proportionate share of the partnership's income that is exempt from taxation under the Constitution and statutes of the United States and by the partner's proportionate share of the partnership's deductions allowed or allowable under Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.

(e) After determining the amount of business income attributable to Indiana under subsection (c), the corporate partner's distributive share of such income shall be added to the corporate partner's other business income apportioned to Indiana and its nonbusiness income, if any, allocable to Indiana, in determining the corporate partner's total taxable income.

As part of this supplemental protest, taxpayer provided documentation establishing that it held unitary partnership interests in four partnerships, and the extent of its income from those four partnerships. Taxpayer states that the sales factor numerator should include income from all four partnerships, as provided by 45 IAC 3.1-1-51. Taxpayer also states that the income from two of the partnerships is not attributable to Indiana and should therefore not be included in the sales factor numerator, as provided by 45 IAC 3.1-1-52.

Taxpayer contends that the Department included its share of partnership income from only two of those four partnerships in the sales factor denominator, and should include the other two partnerships as well, thereby increasing taxpayer's sales factor denominator. Also, taxpayer states that the Department did not remove apportioned book income from one of the partnerships, even though it did remove the apportioned book income from the other three partnerships, as provided by 45 IAC 3.1-1-153(b). Also, taxpayer states that the Department did not remove intercompany receipts from two of the other partnerships. Taxpayer believes that the final apportionment percentage for 1998 should be .83 percent, rather than 1.46 percent as determined in the audit.

In conclusion, taxpayer is correct that income from all four unitary partnerships should be included in its sales factor denominator, as provided in 45 IAC 3.1-1-51. Taxpayer is also correct that intercompany sales should be eliminated from the sales factor, as provided in 45 IAC 3.1-1-153(2). Finally, taxpayer is correct that its Indiana adjusted gross income tax apportionment factor should be adjusted to .83 percent for 1998. As part of the rehearing process, taxpayer provided sufficient documentation to support its position.

### **FINDING**

Taxpayer's protest is sustained.